Betterment of Life Insurance Service

RELATION OF THE RAILROAD AND ITS SECURITIES TO LAND VALUES

Relation of Life insurance investments to city development,

by

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BY

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THE RELATION OF LIFE INSURANCE INVESTMENTS TO CITY DEVELOPMENT

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VARIOUS PROBLEMS CONNECTED THEREWITH

A stranger to our shores, sailing slowly up through the mists of early morning, which are lying in long, horizontal rifts over New York Bay, suddenly catches, as he looks eagerly ahead, fairy-like glimpses of a colossal city floating, as it seems, in a mirage between blue water and blue sky,—vast blue-gray or creamy towers rising through the strata of mist with their thousand windows shining in the reflected sunlight, emblems of the genius and burning energy that caused them to spring into being.

As the ship draws nearer and the white mists give way to blue sky and sunshine, Manhattan's great castles of commerce shake off their veil of clouds and emerge, majestic and awe-inspiring,—symbols of the sovereignty of the people who created them, built not by conscript labor at the command of some despotic government, built not as royal pleasure whims out of the toil of ignorant slaves, but veritable towers of trade, palaces of the people, housing armies of workers in clean, sanitary offices and workrooms, equipped with every modern comfort and inter-connected with the electrical devices which spin together in one vast fabric the business genius of the business metropolis of a business nation.

What has caused these superb walls to rise here on the shores of the new world, edifices shaming with their strength the walls of lofty Rome, in the beauty of many of them showing the heritage

of Greek culture, but imbued with the boldness of youth? What has brought into being a scheme of building vaster than that of the pyramids? This is a land where each citizen has a chance to work out his own career, where the individual is master of his own destiny. What then is the centralizing force which inspires armies of workmen, the genius of the engineer, the architect, the financier, all to labor together in the erection of the world's mightiest fabric, the American office building?

And, as the stranger comes ashore and explores New York City, he finds not only innumerable office buildings and apartment houses and department stores and railroad stations and bank and insurance buildings, all built by this mysterious new world force, but also great hospitals and libraries and art galleries and charitable institutions of all kinds and spacious homes, all of them striking results of seemingly unlimited labor and skill purchased by vast accumulations of money. That, perhaps, is the crowning mystery of all in this country of individualism. How come there to exist these stores of wealth which seem to rival the treasures of the Incas? And as this visitor to our shores travels about our land he finds that, by what is evidently the same financial system, the barren plains, once covered with dusty sage-brush and peopled by the coyote, have been converted into prosperous and fertile ranches, that the desolate ranges are now the grazing grounds of herds of cattle. The farmer has been provided with modern and adequate buildings and farm machinery and villages and towns have sprung into existence, laid out, not in little shacks and cabins of the frontier, but in spacious streets, imposing in their long lines of commercial buildings and in park extensions beautified with handsome homes. What is the secret, the inspiration and the cause of this gigantic blossoming out throughout the land of the builders' art?

The mortgage is the master builder of the new age,—the Rameses II of America. By it the individual secures the necessary co-operation to expand his acreage, to erect his farm buildings, his home and his business habitation, and firms or corporations may, without withdrawing their own capital from their business, build spaciously and for the future by drawing upon the accumulated capital held by various investing institutions.

As a developer of high class real estate through the use of the mortgage, the life insurance company stands pre-eminent. It gathers, in innumerable small amounts, the savings of the many, and sends this accumulation forth again in larger amounts to earn more

money for their owners and to be one of the factors in providing the wherewithal for the building up of America. The great wheat farms of the West, the cotton industry of the South, the railroads and terminals and docks and business houses of modern America have received a generous share of the needed financial help through that greatest of economic powers for good—the life insurance company.

What would San Francisco have done, for instance, in its magnificent outburst of civic pride and individual courage which has caused to spring into being, in these few years since the great fire, the wonder city of the West, if its indomitable workers had not received the cordial approval and help of the great money investing institutions?

In the last twenty years what a host of noble buildings have sprung up in such cities as Chicago, Spokane, Seattle, Salt Lake City, Jacksonville, Los Angeles, St. Louis, Atlanta, Newark, Minneapolis—I choose them at random—and what beautiful residence additions have come into being, all made possible by the skilled, judicious placing of mortgages!

We, the investors of other people's money, have naturally the problem always confronting us as to what is wise and what is not. We must make our trust funds produce adequate earnings, but we must not be so anxious for large earnings that we run risk of loss. We conceive our duties as trustees to be to obtain for the policyholders, whom we represent, as large an income as we can properly receive with due regard to security and the only way the law permits us to invest these funds is in the form of mortgage. I am referring to those companies which are amenable to the laws of New York State. Our investments must be secured by property. We cannot take any chances in business enterprises; we cannot become partners of any commercial concern by becoming shareholders. We can invest only in mortgage bonds or in real estate mortgages which are first liens on the property.

It is the large life insurance companies and savings banks that are evidently the city builders, for it is they who make possible the monumental buildings of which American cities are most proud and it has been ably argued that the great companies should give preference to large loans for the reason that the small borrower has many places to go for his money, but the borrower of a million or more can only go to the great life insurance companies or to the great savings institutions. Is it not a special duty of the officials of a large life insurance company, charged as they are, with the responsibility of ad-

ministering large funds and who must have the good of the whole community at heart, to give especially earnest attention to these large, long time loans? Is it not the duty of those administering the largest fund accumulations to meet the needs of the largest borrowers who can go nowhere else, leaving, as a general rule, the small borrowers to be taken care of by the smaller companies? It is at least safe to say that the making of large loans is a special duty of the big companies, though in practice it is generally considered expedient not to overlook the small borrower as well.

So far as developing American cities is concerned, our influence is all toward conservatism. Speaking for our own company, we do not, for instance, make any farm or suburban loans or upon any property where the continuance and success of the business itself which is housed by the property has anything to do with the investment; that is to say, we would not loan upon a large factory with small land value or where the building is adapted only to the kind of business that it is housing, for the reason that, if the business should not succeed, we would not care to be in a position where we would have to take over its management. We avoid what we call top-heavy loans, basing our judgment as to the desirability of the loan to us largely on the ground value and we confine our loans to the larger cities where real estate values are more permanently established. As this general system of conservatism is followed by many of the large insurance companies in this country, the effect of the investing of life insurance funds upon city development therefore is one of conservatism.

The real estate investor has the satisfaction of feeling, when he secures his loan, that his judgment is backed up by the experience and expert knowledge of the lending institution, which, when it lends its money on his property, becomes, in a way, its backer and foster parent. It becomes a sort of mentor and guide, an authority on real estate, and the owner and developer receives the benefit of its advice.

The speculative builder, the factory promoter, the speculator in suburban real estate, do not apply to the large life insurance companies for funds, but, on the contrary, the builders of substantial business houses, located in what might be called the backbone of the city's commercial activity, turn at once to them and a large percentage of the most substantial buildings in America have been erected by the aid of the accumulated funds of the great life insurance institutions.

In loaning in other cities than our own, we must always beware of fictitious land values brought into existence by that clever system of city booming now prevalent. Local appraisers sometimes with perfect honesty quote land values far greater than they should be—not greater than they appear to be at the time of appraisal, but greater than they should be. If, by a lot of enthusiasm, city slogans and a newly awakened city pride—combined with an eye to the profits—you can get enough men in a city to believe that land is going to rapidly increase in value, a series of sales will follow which seems to fulfil this hope. So a temporary, inflated market value is established which bears no true relationship to permanent value. In this case our natural American optimism is often an element of danger for, while the boom is in progress, it is only those of broad vision and cool judgment who can discount the natural and often perfectly honest local enthusiasm. So the lending institution becomes, in a case like this, a heavy balance wheel.

The problem of the making of farm loans is also an interesting one. Many large companies have been eminently successful in this form of investment because they have made it a special study and know the land on which they are loaning, so that the business risk—that is, the effect of the success or failure of the individual farmer in operating his farm—upon the value of a mortgage is immaterial. The same practice is followed by companies that loan upon small homes. The general principle, I think, obtains in the mortgage loaning departments of all sound life insurance companies that their mortgages must be adequately protected by real property and that the personality or the financial standing of the bond-signer, be he an individual or a corporation, is comparatively unimportant.

An analysis of the assets of American life insurance companies is interesting as showing that there is a decided trend, during the last ten years, toward real estate mortgages, balanced by the trend away from other forms of investment.

The total admitted assets of all American life insurance companies in 1904 amounted to about two and a half billion dollars and in 1914 to about five billion dollars. Of these amounts 7.2% in 1904 was invested in real estate, which percentage had shrunk in 1914 to 3.4%. In bond investments during the ten years there was a decrease in percentage of total assets from 42.6% to 40.1%. In stocks, from 6.9% to 1.6%. In collateral loans, from 1.7% to .4%. In cash, from 4.1% to 1.9%. In deferred premiums, a

decrease of from 1.8% to 1.3%, and in all other assets, with the exception of policy loans, premium notes and mortgages, a slight increase of from .9% to 1.4%. There was during these ten years a necessary increase in policy loans and premium notes because of recent laws compelling life insurance companies to loan upon their policies. This increase is from 7.6% of the total assets of American life companies to 14.9%. This is a large increase in figures from nearly one hundred and ninety millions of dollars to seven hundred and thirty-five millions. In 1904 the companies had about six hundred and seventy million dollars invested in real estate mortgages; in 1914 they had over one billion seven hundred million so invested, which is an increase of from 26.8% of their total assets to 34.5%. More than one-third of all the total admitted assets of life insurance companies are therefore invested in real estate mortgages and, as American life insurance companies have at the present time about seven hundred million dollars invested in farm mortgages—which, by the way, is more than their total real estate investments of ten years ago—it is evident that over a billion dollars is invested by them in other forms of real estate mortgages, probably the bulk of them upon improved city property.

Every city has its own peculiar problems in the matter of mortgage investment, and the City of New York, because of its unique geographical conditions, is no exception to the rule. Here, as elsewhere, centers of activity of various industries shift from time to time and real estate values rise and fall and move from location to location in a way impossible to predict. Manhattan Island, as it became overcrowded, found it impractical to expand horizontally because of the great rivers on its shores. So it burst its bonds by rising perpendicularly, and a new system of engineering and architecture was given to the world as the result. The building of vast bridges across the East River, the development of ferry service east and west, the opening of the Hudson tubes, the various successive rapid transit systems, all have had their influence in changing trade centers and residential districts. A district at one time occupied by some of New York's most beautiful homes will rapidly deteriorate and be for a time 'twixt wind and weather, neither good residence nor business property. Likewise, a high-class retail district will suddenly fall to lower estate by the whims of fashion.

A general decline in real estate values in American cities

would dangerously reduce the equity above the mortgage in many cases, and in order that we, the insurance company, which is limited by law to loan only up to two-thirds of the property value, may be sure of that margin, we would be forced to demand that many of our mortgage loans be reduced. It is natural that the mortgagor should think it hard that, just at a time when, by reason of unfavorable business conditions, it is most difficult for him to obtain financial help from other sources, he should be required to make a payment on account of his mortgage or to pay an increased rate of interest. The problem of the relationship between mortgagor and mortgagee has therefore been recently a difficult one in certain cities.

Unquestionably the condition of New York City real estate, as a whole, is now, and has been for a year or more, puzzling. Just why values have so shrunken is difficult to explain. The system of steadily increasing the assessment by our city fathers and the high taxes, the harassments and exactions of various city bureaus, the loss of confidence as to the stability of values caused by the startling shrinkages that have taken place in the Broadway wholesale district, for instance from Astor Place southward, the Twenty-third Street shopping district and in many residence quarters; the development of the suburbs made possible by modern systems of transportation and communication,—all these causes have contributed. And so, as a result, we, the investors in mortgages, who must not be caught napping, have had to make the difficulties in the business world more difficult by making what naturally seem exacting and unreasonable demands for loan reductions. We would like to be generous, but how would we be thanked for our generosity if, because of it, the rights of our policy-holders were neglected and our trust funds were impaired or depleted? We are, primarily, the trusted custodians of sacred funds. Our first duty is there.

While, with the sudden and unexpected shrinkage in values in certain parts of this and other American cities, there has been a corresponding rise in others, the balance is not a true one so far as the investor is concerned, for he is disquieted by the thought that, if values have so suddenly dropped in one part of the town, what is to prevent them, at any time in the future, from doing likewise in other parts?

If, for instance, a company owns $100,000,000 of mortgages in a certain city upon property conservatively valued five years ago

at $150,000,000 or $160,000,000, which real estate has now shrunken in value to $100,000,000 or $120,000,000, unless it has kept pace with this shrinkage by constantly calling for payments on account, it will find itself confronted with a situation where the equities above its mortgage have almost vanished. Many foreclosures will then follow. The company will be forced to buy in and manage the properties until a more favorable selling market appears, in the meantime taking what interest it can get out of the rentals. In order to avoid this unpleasant situation, the investing company must be alert to every change for better or for worse in the various city districts where its mortgages are and it must secure reductions from the principal of loans so that, in a falling market, it keeps its proportions of loan value to market value constant. That is why recent history has caused us to be exceedingly wary, and why we are sometimes accused by real estate operators of working against them and against the best interests of the city, by being so parsimonious in the amount we will lend upon properties, and so quick to call for payment on account on the slightest sign of weakness in the real estate market.

But the too optimistic mortgage lender is contributing to an artificial inflation of real estate values which is not of real benefit to any city. Too much optimism on the part of a lender contributes to an artificial inflation of real estate because the selling value of many properties, especially new ones, is largely based upon the amount of mortgage they can command, for equity begins where mortgage leaves off, and the two combined form a basis for the asking price. Of course, the ultimate basis of real estate values is the rent-paying one. No one willingly owns real estate except for the one purpose of collecting rents from it. I do not, of course, refer to the home-owner; that is sentiment, not business. And as a capitalization of rents based upon the going rate of interest is what, after all, in the long run, forms the actual value of a property, the insurance company that lends upon improved real estate must take into consideration the appropriateness of the business activities of the rent-payers to their neighborhood, the appropriateness of the building that houses them, the trend of trade to or away from that neighborhood, the depreciation of the building, and the probable depreciation or appreciation of the land. So the company that has a large

amount of mortgages in a particular city is vitally interested in every phase of its civic life.

For instance, whether the first skyscraper was actually erected in Chicago or New York or elsewhere, the skyscraper fashion was undoubtedly highly developed in New York and has encouraged this form of building in cities all over the country, even where there was absolutely no need for it.

What was a necessity on Manhattan Island became a fad elsewhere. The temptation of the owner of a small city lot to erect a tall building and have a vast rentable space is strong as is likewise the temptation to the office renter to move into the latest thing in office building in his town. So the first one or two skyscrapers in a small city where there is unlimited area for expansion on all sides may temporarily become commercial successes, incongruous as they are, while later, and particularly if additional ones are built, they will not yield proper earnings for the simple reason that the supply may exceed the demand. The mortgage on these would therefore be considered "topheavy" loans—loans unwarranted by land values.

These principles, I presume, apply fairly well to those insurance companies which make large investments in country mortgages. It is probable that the bulk of farm mortgages in this country is owned by local insurance companies, who can more easily keep in touch with the conditions of the countryside which lies not far from their doors.

Thus we see the many activities and usefulnesses of the master builder of our country to-day—the mortgage. And as the suppositítious stranger to our shores, referred to in the beginning, returns, after his travels, to New York and sails away down the bay with memories of the multitudinous activities of a great free people crowding his mind, he takes a parting look at that striking sky line of Manhattan Island, rising like the serrate peaks of some mountain range, now but a dim silhouette against the sky, he cannot but realize that in this new land an idea and a force have been developed to undreamed-of proportions and that through it a mighty beneficence and stimulus have inspired the workers of the land from ocean to ocean.